

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Monteith Analyst: Roger Lackey Bill Number: SB 1336

Related Bills: None Telephone: 845-3627 Amended Date: 01-05-2000

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Credit for Guaranty Fee Paid to the U.S. Small Business Administration

### SUMMARY

This bill would provide a credit equal to the amount paid to the U.S. Small Business Administration as a guaranty fee related to obtaining guaranteed financing.

### EFFECTIVE DATE

This bill would apply to taxable and income years beginning on or after January 1, 2000.

### BACKGROUND

The United States Small Business Administration's (SBA) loan program charges lenders a guaranty and a servicing fee for each loan approved. The amount of the fees is determined by the amount of the loan guaranty.

When the guaranteed portion of the loan is \$80,000 or less, the guaranty fee will be 2% of the guaranteed portion; for loans more than \$80,000 but less than \$250,000, a 3% guaranty fee will be charged; for the next \$250,000 of the guaranteed portion, a 3.5% guaranty fee will be charged; and for any portion greater than \$500,000, a 3.875% guaranty fee will be charged.

In addition, all loans are subject to a 50 basis point (0.5%) annualized servicing fee, which is applied to the outstanding balance of SBA's guaranteed portion of the loan.

These fees can be passed on to the borrower once they have been paid by the lender.

### SPECIFIC FINDINGS

**Current federal and state laws** provide for various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child and dependent care credits) or to influence business practices and decisions.

**State law** allows certain credits related to financing. The Farmworker Housing Loan Credit encourages banks to lend money at a reduced interest rate for the construction of farmworker housing. The Community Development Credit encourages deposits into financial institutions which are certified as having community development as their primary mission.

#### Board Position:

<u>      </u> S	<u>      </u> NA	<u>      </u> NP
<u>      </u> SA	<u>      </u> O	<u>      </u> NAR
<u>      </u> N	<u>      </u> OUA	<u>  X  </u> PENDING

#### Department Director

#### Date

Gerald H. Goldberg

2/11/00

**This bill** would provide a credit equal to the amount paid to the U.S. Small Business Administration as a guaranty fee pursuant to obtaining guaranteed financing.

The credit provided for in **this bill** would apply only if the guaranty fee were paid or incurred in a county of this state that has twice the average California Unemployment rate.

#### Policy Considerations

This bill does not specify a repeal date. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date is added, the department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

This bill would provide a 100% credit equal to the guaranty fee paid to the U.S. Small Business Administration. Generally, credits are equal to a percentage of the expenses or costs associated with the credit.

This bill would allow a credit for a deductible expense, thereby providing a double benefit for guaranty fees paid or incurred. In many cases, the deduction for an expense that generates a credit is reduced or eliminated to minimize or eliminate this double tax benefit.

#### Implementation Considerations

It is unclear who is entitled to receive the credit, since the lender pays the guarantee fee to the SBA upon obtaining guaranteed financing. The lender may pass on the guarantee fee to the borrower, but the borrower would pay this passed on amount to the lender, not the SBA. As a result, as the bill is drafted, the lender could claim the credit even though the lender passes on the fee to the borrower, and the borrower would not be allowed to claim the credit because the borrower didn't pay anything to the SBA. The author's staff has indicated it is the author's intent to allow the credit to the borrower, not the lending entity. See Amendments 1 and 2.

It is unclear how and when the local unemployment rate would be determined. The unemployment rate for the state and the various counties may vary during a year, and the current official rate may not be available. The author may consider amending the bill to provide that the unemployment rate used for the eligibility for this credit shall be the California unemployment rate and the respective county unemployment rate applicable at the time the taxpayer obtained the guaranteed financing and incurred the guaranty fee.

It is also unclear when a business would be considered to be "in a county in this state that has twice the average California unemployment rate." A business could be considered "in a county" if it was doing business in that county, if its principal place of business was in that county, if it had property in that county, if it had employees performing services in that county, or on some other basis.

This bill would only allow the credit in counties where the unemployment rate is twice the average California unemployment rate. However, eligibility for the credit is unrelated to employment by the business obtaining the SBA guaranteed loan. Therefore, taxpayers that have paid or incurred the guaranty fee in seeking guaranteed financing in a county with a lower unemployment rate would not receive the benefit even if these taxpayers increase employment in these counties. Taxpayers in high unemployment counties would be eligible for the credit even if the business had no employees.

Once the implementation concerns are resolved, implementing this bill would not significantly impact the department's programs and operations.

#### Technical Considerations

The phrase "guaranty fee" is spelled two different ways (i.e., "guaranty fee" and "guarantee fee") within the bill's text. "Guaranty" is the correct term.

#### FISCAL IMPACT

##### Departmental Costs

Once the implementation concern is resolved, this bill would not significantly impact the department's costs.

##### Tax Revenue Estimate

This proposal is estimated to impact PIT and B&CT revenues as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 1999 Enactment Assumed After June 30, 2000 \$ Millions		
2000-01	2001-02	2002-03
Minor Loss*	-\$1	-\$2

\* Loss less than \$500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

**Note:** The bill does not yet specify a specific time period for meeting the unemployment test. For this analysis, it is assumed the twelve counties referred to below would be the only counties qualifying under this bill.

##### Tax Revenue Discussion

The revenue impact for this bill would be determined by the number of loans guaranteed by the SBA, the number of counties that have an unemployment rate twice that of the state, and the amount of credits that can be applied against available tax liabilities.

This estimate was developed in the following steps. First, according to the Small Business Administration (SBA), the total number of approved and guaranteed loans for California businesses was 8,096 for tax year 1999. Second, this number was increased 2% per year to allow for growth, generating 8,258 loans for 2000. According to the same source, the average loan amount for California was \$250,000. The agency guarantees 75% of their loans, or \$187,500 ( $\$250,000 \times 75\%$ ). The percentage of the guaranty fee ranges from 2% to 3.85% depending on the portion of the loan that is guaranteed. For this analysis it was assumed 2.5% on average would be applied as the guaranty fee, generating a total fee of \$4,688 per loan ( $\$187,500 \times 2.5\%$ ). Third, the total number of loans was multiplied by the average guaranty fee, generating approximately \$38.7 million for 2000 ( $\$4,688 \times 8,258$ ). Fourth, this number was adjusted downward to reflect those counties that have twice the California unemployment rate and would qualify taxpayers for the tax credit under this bill. Currently 12 counties meet the unemployment criterion as of December 31, 1999, and of these counties, total employment of 1.2 million represents 7.5% of the 15.9 million state-wide unemployment. Employment statistics generally are an indicator of economic activity. Therefore, it was assumed for this analysis that 7.5% of the total \$38.7 million in fee payments would qualify businesses for the tax credit, generating a total credit amount of \$2.9 million for tax year 2000. It was assumed that, on average, 15% of generated credits would be applied against available tax liabilities in the first year. The low usage rate was used because start up companies generally have lower tax liabilities or have losses. Losses were grown to reflect a 2% annual growth in loans.

#### BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 1336  
As Introduced January 5, 2000

AMENDMENT 1

On page 2, strike out lines 2 through 5 and insert:

amount equal to the amount paid or incurred by a borrower during the taxable year attributable to a guaranty fee paid to the United States Small Business Administration (SBA) in connection with obtaining financing guaranteed by the SBA.

AMENDMENT 2

On page 2, strike out lines 20 through 23 and insert:

equal to the amount paid or incurred by a borrower during the income year attributable to a guaranty fee paid to the United States Small Business Administration (SBA) in connection with obtaining financing guaranteed by the SBA.